**Paper 2: Economic Releases and Resulting Market Reactions**

**Final Due Date:** Wednesday, February 25 by 11:59 PM (emailed to Professor)

**Goal of Paper:** Prompt students to establish a habit of following the release of important economic factors and subsequent market reactions. By doing so, they will can strengthen their understanding and intuition of how markets respond to the release of new information and to the general economic climate.

**Description:** Your boss needs a summary of important economic releases on February 2 (ISM Manufacturing Index) and February 6 (Payroll Employment (number of jobs added) and the Unemployment Rate). Descriptions of these releases are provided on the following pages from dismal.com.

Watch for these releases and write an assessment for your boss as to the following:

1. How the releases came out versus expected,
2. What they mean for the general economic climate, and
3. How the markets reacted, including 1) what you expected the markets to do, 2) what they actually did, 3) if the actual reaction seemed reasonable to you and 4) why. “Markets” means:
   1. Stock market as represented by the S&P 500 Stock Index (other stock markets can also be included at your discretion)
   2. Bond market as represented by the 10-year Treasury (spread markets can also be included at your discretion)
   3. And, at your discretion, other markets such as certain commodities and currencies.

Bloomberg is a good resources as well as Yahoo Finance for articles and discussions of these reports.

* <http://www.bloomberg.com/markets/economic-calendar/>

Indicator Definition: ***Employment Situation***

**At a Glance**

**Lag Factor** Data for the week, including the 12th of the month, are released the first Friday of the following month.

**Source** Bureau of Labor Statistics

**Release Time** 8:30 a.m. EST

**Revision Factor** Average: Each month, the previous two months’ releases of the payroll data are revised. These revisions can be substantial. Household data are not revised. In October, a preliminary benchmark release for March is available. With the release of the following January's data, the benchmark data are revised. Benchmark data are revised back at least two years, and new seasonal adjustment factors will also lead to revisions.

**Market Impact** Probably no other report is as widely monitored by financial markets.

**What to look for**

* Total change in payroll employment, and industries that account for change as well as the breadth of change.
* Change in average hourly earnings, unemployment rate and labor force.
* Change in aggregate hours worked—this is a good proxy for current GDP growth.
* Change in the workweek; this may be a leading indicator of the change in payrolls.
* The all-employees measures for hours and earnings, which now include both nonproduction or supervisory workers.

**Strengths**

* Provides information on a wide range of industries and regions.
* Short time lag between when surveys are conducted and release date.
* Good indication of emerging wage pressures in average hourly earnings component.
* Employment is a coincident indicator of economic growth, while unemployment is a lagging indicator.

**Weaknesses**

* Subject to significant revisions, since employment is based on a relatively small sample that is augmented using statistical techniques. Because of this methodology, growth could be understated or overstated during turning points in the business cycle.
* Household data are based on a small sample of 60,000 households that is expanded to the working-age population based on age, gender and race. Because of the small size of the sample, there can be large month-to-month fluctuations.
* Subject to large seasonal distortions.
* The unemployment rate, which is among the most quoted economic indicators, may not be the best reflection of labor market slack, since it only includes people who are actively looking for work. The BLS does provide alternate, broader measures, however.
* The household survey sometimes tells a very different story than the payroll survey. Because the payroll survey is based on 400,000 set establishments, it does not capture the birth of new companies. These may be captured better by the household survey, and therefore the household survey may capture turning points in the business cycle better than the payroll survey.

**Brief Description**

Payroll employment (current employment survey) is a measure of the number of jobs in more than 500 industries (other than farming) and in all states and 255 metropolitan areas. This release is the single most closely watched economic statistic because of its timeliness, accuracy and importance as an indicator of economic activity. Payroll figures are reported each month by the Bureau of Labor Statistics, along with information on average weekly hours worked and average hourly earnings. The data are based on a survey for the week or payroll period including the 12th of the month. The release also contains an index of aggregate weekly hours worked, which offers an important early indication of production before the quarterly GDP numbers come out.

The information on average hourly earnings and average weekly hours is probably the third and fourth most closely followed figures in this release, right behind the nonfarm employment number and the unemployment rate. The BLS now reports earnings and hours for all employees, not just production workers in goods-producing industries and nonsupervisory workers in service-producing industries. Prior to 2010, these measures excluded those working in executive or managerial positions. The BLS also releases a survey of households (current population survey), which includes data on the labor force, the number of people employed, and the number seeking jobs—from which the unemployment rate is derived. The household survey provides a very rich data set with data by race, gender, age, marital status, educational attainment and hours worked, as well as reasons for being out of the labor force.

Indicator Definition: ***ISM Manufacturing Index***

**At a Glance**

**Lag Factor** Short: One-month lag. Data released on the first business day each month.

**Source** Institute for Supply Management

**Release Time** 10:00 a.m. EST

**Revision Factor** No monthly revisions, but every January the seasonal adjustment factors are re-estimated and this can lead to changes in the headline number and its components.

**Market Impact** Financial markets are extremely sensitive to changes in the index, as it is one of the first pieces of economic data released each month. Also, because the ISM survey is a diffusion index, it measures the breadth of change across manufacturing. This makes it useful in gauging the economy's momentum, and it is a leading indicator of GDP growth.

**What to look for**

* A headline number above 50 is consistent with both manufacturing and economic expansion. An index below 43 for an extended period is consistent with an economy in recession.
* Changes in new orders are good leading indicators for future production. Also, declines in the customer inventories index typically foreshadow future increases in new orders.
* The employment index will help assess whether factories are hiring or laying off workers. The employment index is useful in predicting changes in the Bureau of Labor Statistics' measure of manufacturing payrolls.
* Changes in the prices-paid index will indicate accelerating or decelerating inflation early in the production process.
* Differences between export and import indices can foreshadow changes in the nominal trade deficit.

**Strengths**

* Provides timely information on manufacturing.
* The ISM index is a good leading indicator of the economy and is useful in gauging turning points in the business cycle.
* Changes in the index are closely linked with changes in gross domestic product. The quarterly average of the ISM manufacturing and nonmanufacturing surveys does a reasonably good job of predicting real GDP growth.
* The difference between new orders and inventories is a good proxy for future production.
* The index has a strong correlation with manufacturing industrial production.

**Weaknesses**

* The ISM survey does not include a wage component, which is an important part of overall costs for manufacturers and can determine inflationary pressures.
* The survey participants are limited to three responses: "slower," "faster" and "same." Therefore, because the survey is a diffusion index, it cannot measure the rate of change in manufacturing.
* The index does not capture technological change and production efficiencies, which make it possible for production to expand while employment contracts.

**Brief Description**

The ISM manufacturing index is based on surveys of 400 purchasing managers nationwide regarding manufacturing in 20 industries. The ISM manufacturing survey is a diffusion index, calculated as the percent of responses that are positive plus one-half of those describing conditions as "same." The index is seasonally adjusted for variations within the year, differences due to holidays, and institutional changes. In January 2008, the ISM announced it would assign an equal weight to the five components that make up the manufacturing index, which include new orders, production, supplier deliveries, employment and inventories. Previously, each component had been assigned a different weight. Information on activity in each of the 20 industries is provided separately. The ISM manufacturing index provides one of the earliest health checks on the economy.